SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1945.

No. 1221.

JANE CROZIER, ROBERTA GIESECKE and HARRIET M. ACKERT,

Petitioners,

vs.

THE BALTIMORE AND OHIO RAILROAD COMPANY.

REPLY BRIEF OF PETITIONERS CROZIER ET AL.

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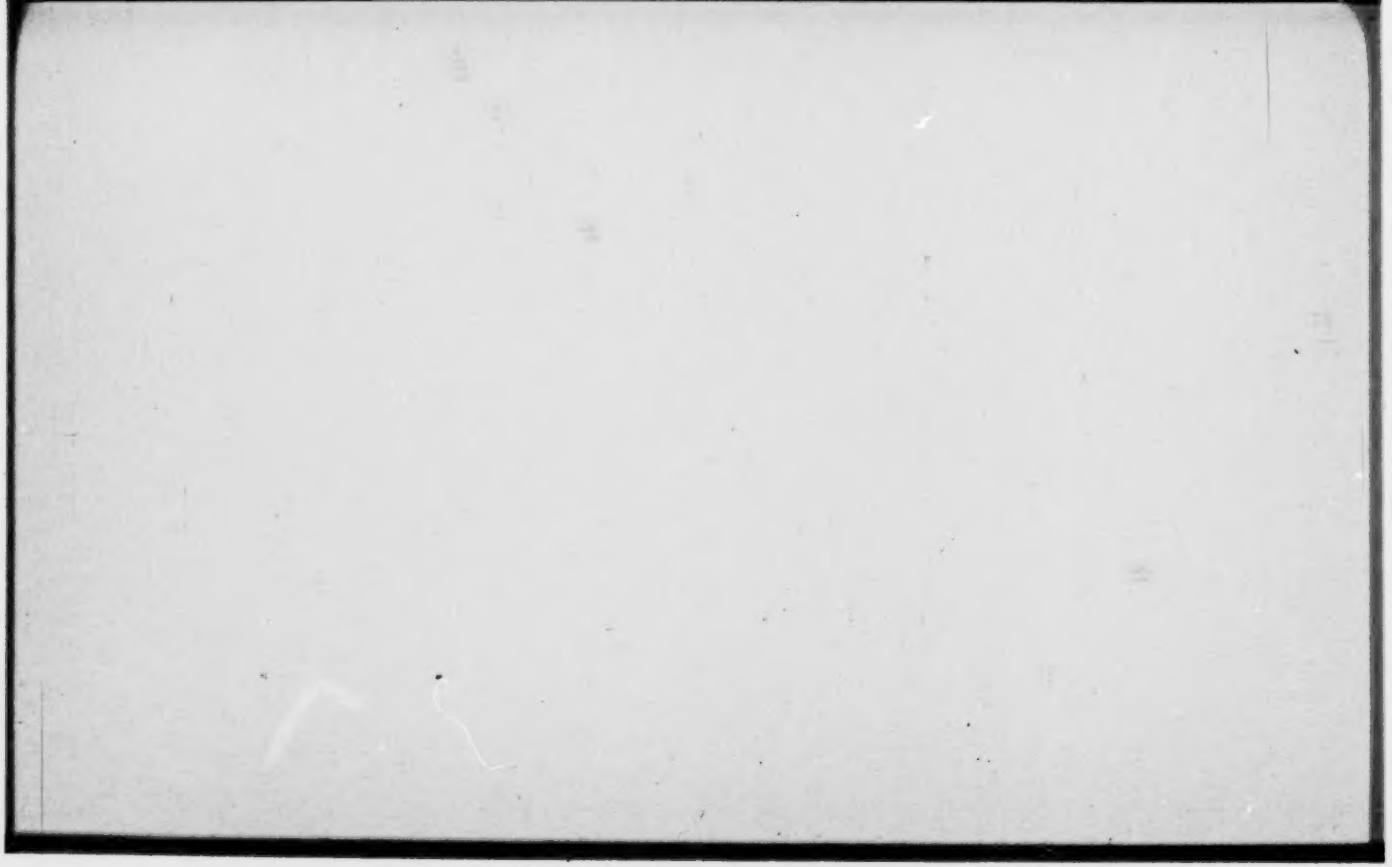

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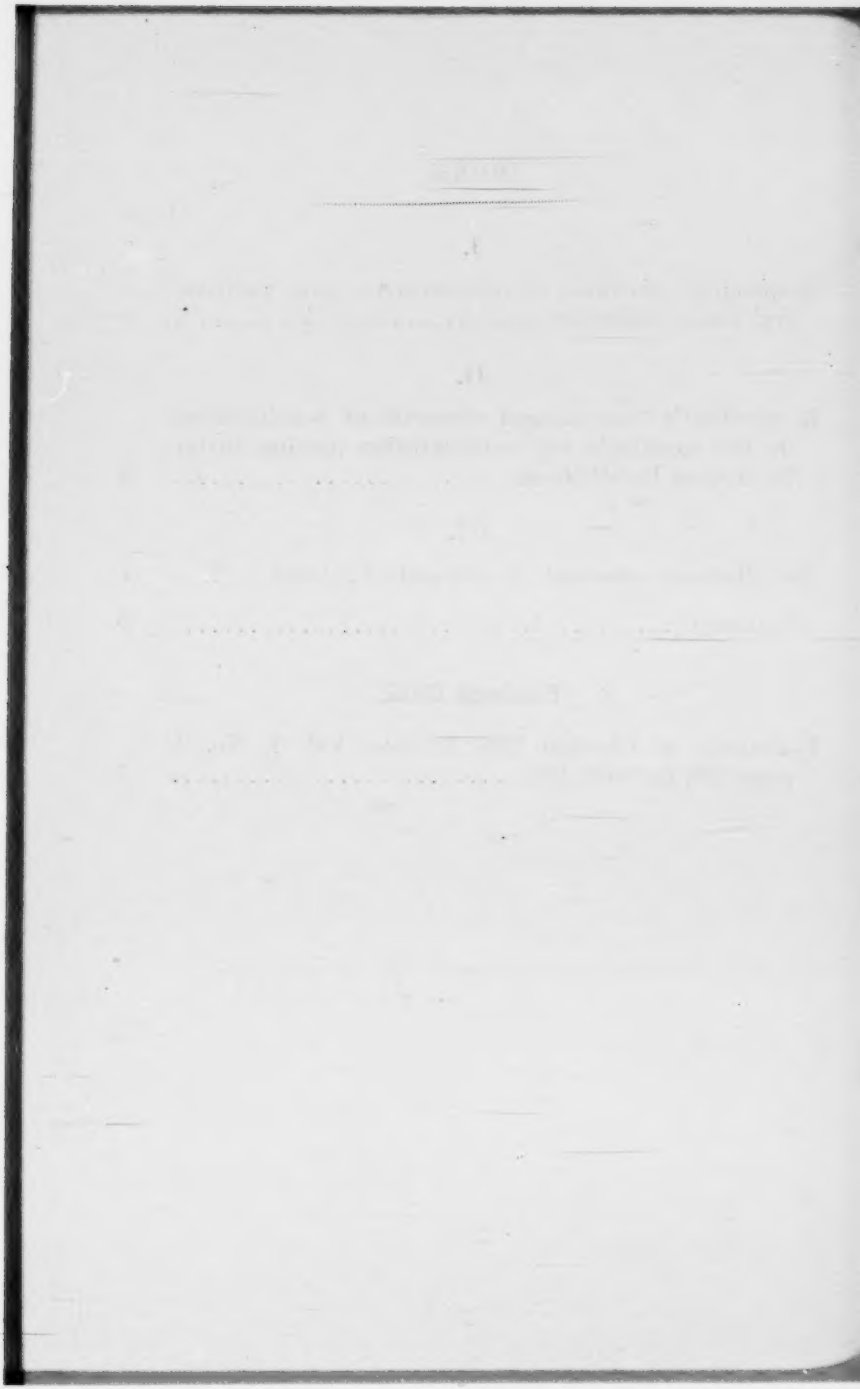

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REPLY BRIEF.

I.

Respondent at page 3 of its Brief attempts to state the position of these petitioners to be that there is no compensation whatsoever for the modification of the Refunding Bonds and that we suggest the modification in the mortgage securing said bonds to permit the refunding or extension of prior lien bonds is not a proper modification under Chapter XV. But that is not quite a correct statement of our position. Our position is that there is no compensation or fair consideration moving to the Re-

funding Bondholders **as a class** to compensate them for the separate and peculiar destruction of a vested right, peculiar to them as a class, which is wrought by the Plan. All of the issues have either principal or interest or both deferred or made contingent, but only the Refunding Bonds have vested rights **obliterated.** The vested right of the Refundings thus obliterated is the covenant against **extension or renewal** of prior lien bonds and, as we argued in our petition, this vested right is of great value and importance to the Refunding Bonds. The Respondent's statement of our position refers to "**refunding** or extension" of prior lien bonds. Whether this misreference is deliberate or not, we again reiterate that our position is not one of objection to **refunding** or any provision which makes refunding possible so long as such provision does not permit a maturity date in the refunding which is later than the extended maturity under the Plan of the bonds to be refunded. The mortgage securing our Refunding Bonds does not contain any covenant against a **refunding** of prior lien bonds; the restriction is only against "extension or renewal." It would appear that Respondent is trying to lead this Court into the same misapprehension of our position which the lower Court seems to have indulged.

At page 5 of Respondent's Brief it purports to list what "the Plan, in outline, as approved and confirmed by the Decree provides." There follows a list of seven features of the Plan, but conspicuous by its absence is the provision of the Plan which **obliterates** the covenant of the Refunding Mortgage against extension or renewal of prior lien bonds. One cannot help but ask why, why, why, did the lower Court so carefully avoid a reference to this destroyed right and so persistently refer only to the extension of maturities and the making of interest contingent (but cumulative), and now we find Respondent doing

precisely the same thing and not simply soft-pedalling the issue of the destroyed right but omitting it entirely in its recapitulation of the features of the Plan.

II.

Respondent's Brief concedes that the strict priority rule applies to a proceeding under Chapter XV, but endeavors to point this Court to what Respondent conceives to be three considerations moving to all bondholders and one moving to the Refundings and Convertibles.[1] These claimed four elements of consideration purported to move to the bondholders are referred to at pages 16 to 19 of Respondent's Brief. They are:

(1) That the Railroad agrees to maintain its property. Of course, as stated, they argue that some three and a half million dollars of annual net earnings must be devoted to the betterment of the property. Even if this does not contemplate mere maintenance, it certainly does not represent any more than any responsible and well managed railroad should provide both for the protection of its bondholders and its stockholders. If anyone benefits by it, the stockholders do just as much as the bondholders. Certainly it cannot be said that this is a special consideration running particularly to the Refunding Bondholders to compensate them for the particular and peculiar rights in their mortgage which are destroyed by this Plan. The mortgages themselves already require the Railroad to maintain its property for the protection of its secured creditors, and to urge that an agreement to retire its debt is a consideration is to overlook entirely the fact that the Plan itself gives Respondent a long extension of

1 Respondent also recognizes on page 7 of its Brief that we argue the lower Court went beyond its jurisdiction in approving the provision of the Plan which annihilates the covenant against extension or renewal of prior lien bonds, but it neither denies such charge nor makes any argument that the Court did not exceed its jurisdiction in this respect. Its Brief is entirely silent on that point.

time in which to retire debts now due or about to mature. It is putting the cart before the horse.

(2) That the stockholders relinquish their right to have distributed to them as dividends the present book earned surplus of the company. Again Respondent overlooks the fact that the surplus (absent this Plan) is charged with the payment of debt already matured or about to mature and which the Railroad urges it is unable to pay. The stockholders could have no dividends from this source, nor any hope of it, unless this Plan is confirmed and those debts extended. In addition to this, the Plan forces the bondholders themselves to relinquish their right to have distributed to them, as interest or for the payment of presently matured or about to mature principal, of any part of the book surplus and limits the bondholders to net earnings available for interest and the other features contained in the allocation of earnings under the Plan. Moreover, the bondholders, unlike the stockholders, give up the right to payment out of capital assets. Dividends can never be paid out of capital, but bonds and the interest thereon can be. Surely, then, this is no real consideration moving to the bondholders, and even if it is, it moves to all of them alike and constitutes nothing special to the Refunding Bondholders to constitute fair consideration for the destruction of the covenant in their mortgage against extension or renewal. In the footnote at the bottom of page 17 the Respondent argues that if their 1944 maturities could have been extended without the conditions imposed by the holders thereof, the earnings that year could have been used to pay $3.00 per share on Common Stock and $4.00 per share on the Preferred Stock. This cannot help but remind us of the old remark that, "If there had been wheels on grandma, she would have been a wagon." The whole point is that the stockholders have not surrendered any right because their obligation was to pay the maturities and to pay the fixed interest,

and the Plan instead grants them more liberties and removes the present insurmountable restrictions (matured and about to mature indebtedness and fixed interest) upon the paying of any dividends. The argument indeed is one in reverse and should not mislead this Court.

(3) That the Plan provides for the cancellation of approximately $3,600,000 of bonds of issues affected by the Plan now held in the Respondent's treasury and which but for the Plan could be reissued. In the Trial Court it was urged that the cancelled bonds would amount to $6,350,000, and Respondent in its Brief to that Court so argued on page 29 thereof. In our Brief to that Court we pointed out that of this amount $2,668,000 of such bonds were already held by the mortgage trustees, and it is our belief that the remaining $3,600,000 were acquired by the company from funds created by the capital or sinking fund provisions under the 1938 Plan. It is an odd argument for a debtor to urge that he gives consideration to his creditors, particularly a new consideration moving to them, when he pays his indebtedness, and yet in the final analysis that is the argument the Railroad is here making. Furthermore the Plan gives Respondent the express new right to issue additional bonds which in reality makes this small cancellation meaningless. Once again it can not be argued that this is a consideration, if it is one, moving peculiarly to the Refunding Bondholders to compensate them for the destroyed rights.

(4) The fourth and last element of consideration claimed by the Respondent is the conversion privilege in the Convertible and Refunding Bonds. Whether extending the conversion privilege of the Convertible Bonds over the additional fifty years during which the maturity of the Convertible Bonds is extended is any consideration moving to them is a point we need not discuss, but with respect to the conversion privilege in the Refunding

Bonds, that privilege was granted to them under the 1938 Plan for a partial modification of the covenant against extension or renewal of prior lien bonds and was granted to them in that Plan for the life of those bonds. Their maturity is not extended by the present Plan. The 1944 Plan was ambiguous with respect to the conversion privilege for the new Refunding Bonds proposed to be issued to consummate the Plan. We challenged the apparent elimination of the conversion privilege by the present Plan on the ground that it had become a vested right for the duration of the bonds by virtue of the 1938 Plan, and the Respondent's counsel stated in open court that it was not the intention by the Plan to deprive Refunding Bondholders of the conversion privilege they had under the 1938 Plan. Nevertheless the lower court required a modification of the Plan to make retention of the conversion feature unmistakably clear, but such action retaining an already existing right cannot be said to create any consideration moving to the Refunding Bondholders under the Plan now before this Court.

Respondent's Brief (bottom page 19) points out that because of the Plan, so long as bondholders do not receive their current due, the stockholders can get nothing. This is true, **but it is also true without a Plan.** Respondent, however, does not point out the corollary which is that without the Plan, the stockholders could not get anything, whereas with the Plan they could declare a dividend the day after it became effective. This shows rather conclusively who gets the benefits from the Plan. Respondent's reference to recognized financial services which would rate the new bonds as better than those now outstanding disregards the fact (pointed out in our Brief below) that the same Moody Service which made the statement contained in the Respondent's Exhibit PX-98 we subsequently learned made the following statement in their Bond Survey of September 10, 1945, at page 203:

> "In any event should the Plan fall through, it would not importantly change the position of bondholders, which, in the final analysis, will hinge principally on earnings."

Perhaps the Respondent was unaware on September 17 through September 21, 1945 that the very Moody Service on which they relied had made this statement about the Plan. At any rate they only introduced into evidence Moody's much earlier publication in which that service estimated the rating of the bonds would be slightly improved if the Plan were consummated.

III.

Respondent's Brief recites (p. 5) that this is the fourth decision of a Court under Chapter XV which the Supreme Court has been requested to review on certiorari. It is true that the other three applications have been denied but, insofar as we are able to ascertain, none of the other three raised the points raised in our petition. In fact, Professor Hubert Will of the University of Chicago in an article written for the University of Chicago Law Review expressed some surprise that in the first such application to this Court for certiorari **(309 U. S. 654, 84 L. ed. 1003)**, "The Petitioner's Brief surprisingly did not question the fairness of the B. & O. Plan, however, so the denial of the petition casts little light on what constitutes a 'fair' Chapter XV Plan." **(University of Chicago Law Review, Vol. 7, No. 2, page 220, Footnote 100.)**

It is a completely unsupported statement which Respondent makes (Brief, p. 11) that we endeavor "to prevent, delay or make **refunding** operations more cumbersome." We deny any such purpose and cannot help but believe that Respondent makes such charge against our petition in an effort to confuse this Court as to the precise purpose of our objection to the complete elimination

of the covenant in the Refunding Mortgage against extensions or renewals. Our objection is against a program designed to permit the company to extend maturities of prior lien bonds beyond 1980.

In the fourth and fifth lines on page 15 of its brief Respondent endeavors to create the impression that the Plan destroys no rights absolutely because, as they say, "No affected creditor's claim is scaled as to either principal or interest." The statement is true insofar as it goes, but it is not the whole truth. The Plan does more than simply "postpone" the enforcement of rights, and it is the utter annihilation by the Plan of the covenant contained in the Refunding Mortgage against renewal or extension of prior lien bonds to which we object.

Appendix A to Respondent's Brief is intended to deal only with Convertible Bonds. It was contained in the Railroad's original Brief to the lower Court as Appendix F. It is only fair to point out that of the allocation to "Sinking Fund, Paragraph (6), Article III," and "Additional Sinking Fund Payments, Article VII," the Plan permits the Board of Directors of Respondent (Article VI of the Plan) to apply one-half of such payments to working capital and/or the cost of capital investments. So long as the Board has this discretion, it is improper for the Respondent to try and lead this Court into the belief that the sums shown on those two lines of their Appendix A would all be put into the sinking fund because, in fact, a substantial part of the item marked "Total Sinking Fund Payments" can and probably will at the sole discretion of the Directors representing the stockholders be diverted from the sinking fund and put into the company's **working capital.** It is very misleading for the Respondent to have given this Appendix to the Court without explaining the effect of the provisions of Article VI of the Plan.

CONCLUSION.

It is respectfully submitted that the application of these Petitioners for a Writ of Certiorari should be granted.

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